No. 304

IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

ELMER F. REMMER, *Petitioner,*

v.

UNITED STATES OF AMERICA.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR PETITIONER

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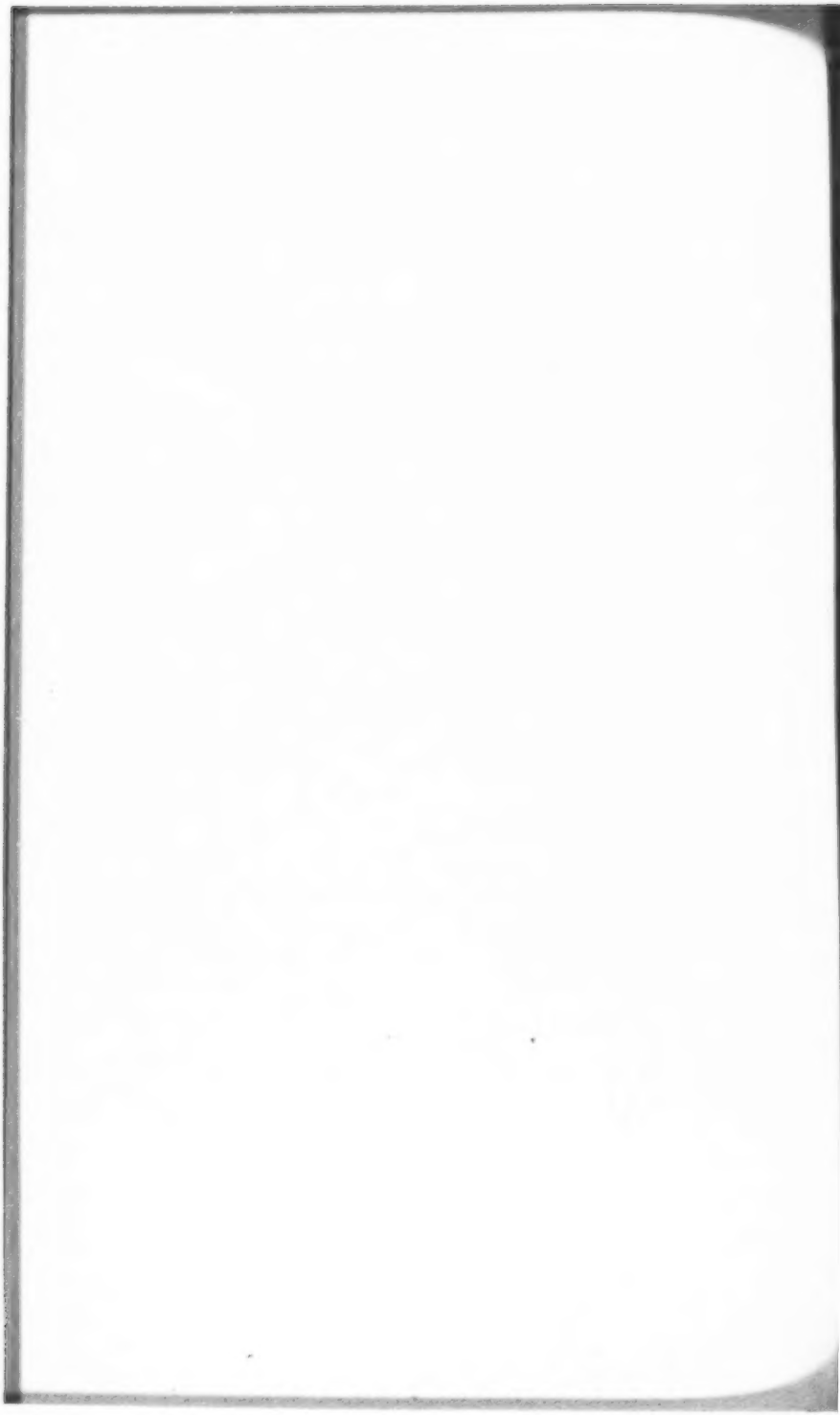

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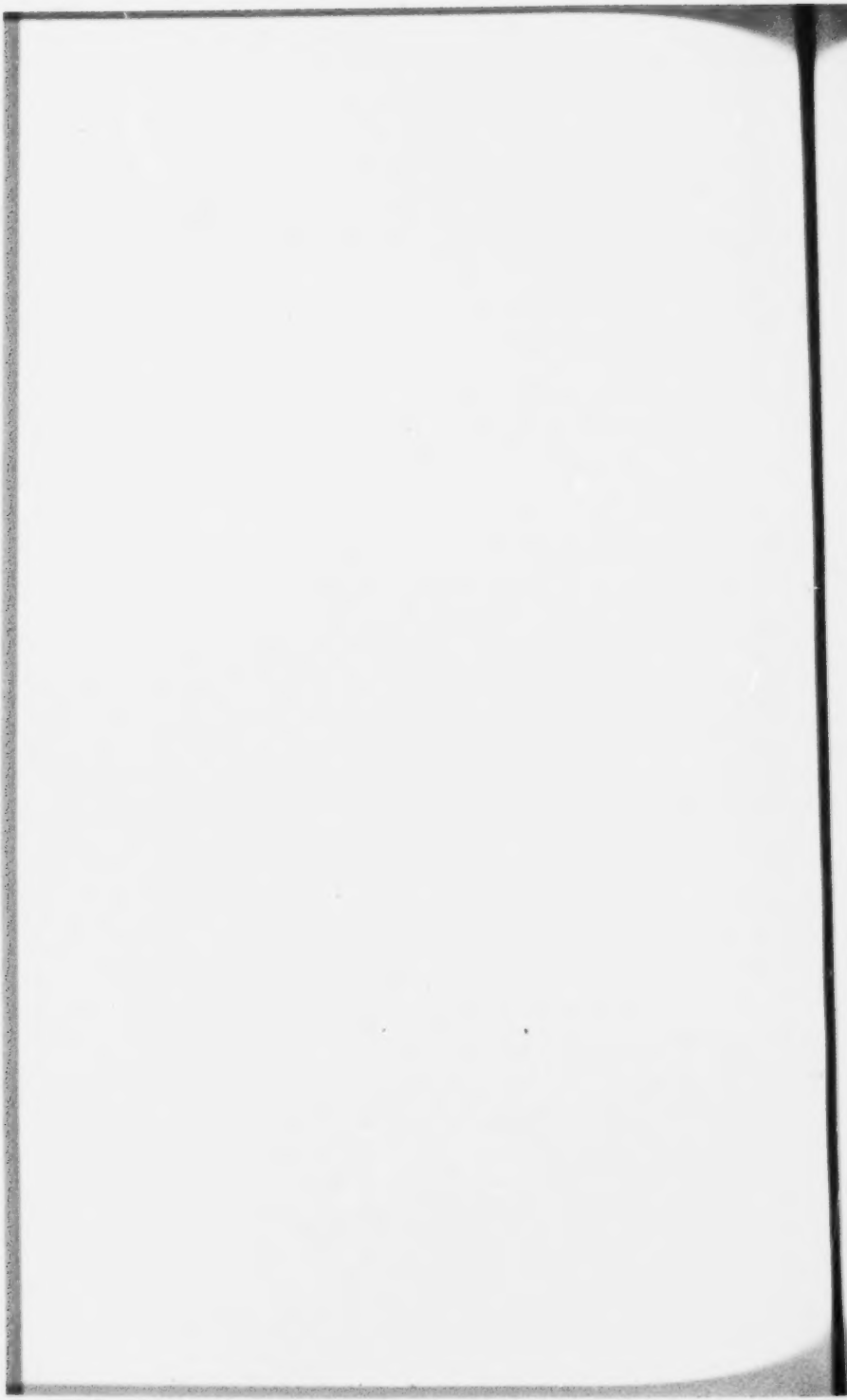

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OPINIONS BELOW

The District Court wrote no Opinion. The Opinion of the Court of Appeals (R. 3748-3777) is reported in 205 F. 2d 277.

JURISDICTION

The judgment of the Court of Appeals was entered on May 28, 1953 (R. 3778). An order denying a petition for rehearing, rehearing en banc, and staying mandate was entered on June 30, 1953 (R. 3779). On July 17, 1953, an

order was entered by Mr. Justice Clark, extending the time for filing a Petition for Writ of Certiorari to and including August 29, 1953 (R. 3781). The Petition was filed on August 28, 1953. The jurisdiction of this Court is invoked under Title 28, USC 1254. See also Rules 37(b)2 and 45(a), Federal Rules of Criminal Procedure.

QUESTIONS PRESENTED

1. Do mere errors in the taxpayer's books authorize the Commissioner to substitute another method of accounting?

2. Was the sufficiency of petitioner's accounting system a question for the jury?

3. Where all of the books and records are not in evidence, the court has denied petitioner's motion for discovery, and has quashed a subpoena requiring the Government to produce a mass of petitioner's original records, can a finding be made that petitioner did not keep adequate books which clearly reflect income, so as to permit a computation on the net-worth theory?

4. Where it is clear that a computation by the net-worth method has omitted an asset shown to have been in existence at the beginning of the indictment period, can any assumption be made that the difference between the net worth at the beginning of the year and the net worth at the end of the year represents taxable income received during the year?

5. Without that assumption, does a net-worth computation establish a prima facie case of unreported income?

6. In computing income by the net-worth method, must the traditional basic distinction between the cash and accrual methods of accounting be observed or is the net-worth method independent of conventional accounting concepts?

7. May accounts receivable be included in a computation of net-worth on the cash basis?

8. Does the defendant have the burden of establishing the amount of a cash item which has been omitted from the Government's net-worth computation?

9. Are the tests for determining whether partnerships will be recognized for the purpose of computing civil liability, equally applicable to the determination of liability for criminal penalties?

10. Are the tests used in civil cases so clear and certain that a defendant in a criminal case can properly be charged with knowledge in 1945 and 1946 of the development of the law in this field up to the year 1949?

11. Does Rule 16 of the Rules of Criminal Procedure, providing for a motion for discovery and inspection "at any time after the filing of the indictment", authorize the denial of the motion on the ground that it is not timely?

12. If timeliness is an element, does the Rule permit the time to be charged against the defendant where the Government has contributed to the delay?

13. Does Rule 16 of the Rules of Criminal Procedure authorize the court to substitute its judgment for the defendant's and to deny inspection of records on the ground that the court disagrees with the defendant's appraisal of the expected benefits?

14. Does Rule 16 of the Rules of Criminal Procedure require a showing of the specific need for individual papers?

15. In a case where there is no suggestion that compliance with the subpoena would have hampered the Government in any way, does Rule 17 of the Rules of Criminal Procedure permit the quashing of a subpoena for production of documentary evidence on the ground that the motion was not timely, that the production would not be beneficial to the defendant, and that the defendant had failed to show the need for specific papers?

16. Where outside contact with the jury is alleged to have occurred during the trial, is the defendant entitled to a hearing to determine the facts, and to a new trial if warranted by the facts, or may the District Judge, who is reported to have already made an investigation, unknown to petitioner, deny the motion without comment and make no official record of the occurrence?

STATUTES, RULES AND REGULATIONS INVOLVED

The pertinent statutes, rules and regulations are set forth in the Appendix, infra, pp. 49-56.

STATEMENT

Petitioner was convicted in the United States District Court for the District of Nevada, upon an indictment under Section 145 (b) of the Internal Revenue Code (26 USC 145 (b)), charging that petitioner willfully and knowingly attempted to defeat and evade income taxes for the years 1944 and 1945. The jury disagreed with respect to additional counts which involved the year 1946.

During the years 1944 and 1945, petitioner was in the gambling, cafe and food business (R. 1032, 1134, 1290). Petitioner and his wife filed separate returns. Each return showed the combined income and, on the community property basis, calculated a tax on one-half (R. 3519-3529). The returns of both petitioner and his wife disclosed income from the following enterprises (R. 3525, 3527-8):

San Diego Social Club and 21 Club
The 311 Club
The Menlo Club
110 Eddy Club
186 Day-Nite Club
186 Day-Nite Cigar Store

Corporate returns were filed for the 186 Club (Ex. 87-87A, R. 3541, 3551). (Ex. 88-88A, R. 3562, 3563). Partnership returns[1] were filed for the following enterprises:

21 Club (1944 return, R. 1077)
21 Club and San Diego Social Club (1945 return, R. 1076)
311 Club (1944 and 1945 returns, R. 1077)
110 Eddy (1944 return, Ex. 81, R. 3531)
110 Eddy (1945 return, Ex. 82, R. 3533)
186 Day-Nite Cigar Store (1944 return, Ex. 84, R. 3535)
186 Day-Nite Cigar Store (1945 return, Ex. 85, R. 3538)
[2] Menlo Club (1945 return, Ex. 89, R. 3576)

Each return showed that petitioner had an interest.

A partnership return for the year 1944 was also filed by the B-R Smoke Shoppe (Ex. 78, R. 3530). It showed that petitioner had a one-half interest and that his share of the income was $600. The witness, Lando, who was shown on the return as a partner of the B-R Smoke Shoppe, testified that 1945 was a loss year (R. 1330). See also R. 1965, 1968.

On the premise that some of the partnership books were incomplete, the income of all of the partnerships was recomputed by the prosecution on the theory that increases in net worth represented taxable income. This assumed that the partnerships were the individual enterprises of the petitioner, which was the principal issue in the case. If the partnerships were recognized and petitioner's individual books were adequate, the use of the net-worth method in a prosecution of petitioner as an individual would have raised other questions. A revenue agent testi-

[1] The return forms were designed for partnerships, syndicates, pools, joint ventures, etc. (R. 3530). They are commonly referred to merely as partnership returns.

[2] The Menlo Club did not begin operation until 1945.

fied that the 21 Club had a fairly complete set of records, consisting of a general ledger, journal, and cash receipts and disbursements (R. 1250). Witness Semenza testified as to the condition of the books (R. 3275, 3281, 3283-5, 3287, 3289, 3290, 3299, 3413, 3415, 3417, 3418) and concluded that they were adequate (R. 3432).

Although the prosecution's own case included uncontradicted evidence that varying amounts of cash were held in safes and deposit boxes throughout the years involved (R. 1268, 1484, 1535, 1536), the prosecution exhibit used in computing petitioner's net worth at the beginning of 1944, 1945 and 1946 showed no figures for cash outside the banks (Ex. 183, R. 3613). Witness Semenza testified that without that cash figure it was impossible to determine correct net worth (R. 3292-3). Two government witnesses reluctantly agreed (R. 2557-8, 2878-80). Government counsel instructed the accountant with respect to treatment of various items (R. 2870-78-81-85).

The prosecution computed the net worth of each partnership separately. For present purposes the Court is concerned only with the following four partnership enterprises:[3]

110 Eddy Street (Ex. 163, R. 3589)
Day-Nite Cigar Store (Ex. 164, R. 3593)
Menlo Club (Ex. 165, R. 3597)
B-R Smoke Shoppe (Ex. 169, R. 3601)

These computations were based on the petitioner's books and records and were merely a restatement of the results

[3] The 186 Club was treated by the prosecution as a corporation and therefore no net worth figure representing its income was included in Ex. 183. The 186 Club occupied the back room of Day-Nite Cigar Store (R. 1425). It was bought in 1943 by Nealis and Kopstick (R. 1425), who later withdrew and were paid off (R. 1427). The prosecution recognized the partnership status of the 21 Club and San Diego Social Club (R. 2894). In Tax Court proceedings all enterprises are recognized as partnerships. *Remmer v. Commissioner*, Docket No. 23486.

of the operations in a different accounting form. Some changes involved the capitalization of improvements instead of treating them as expenses (R. 1268, Ex. 165, 174), and the treatment of taxes as additions to costs instead of as expense items, Ex. 175. The prosecution did not rely on the discovery of any specific item of new income or any new source of income beyond those reported in the books or tax returns.

After calculating the net worth figures of the partnerships separately the figures were transferred to a composite exhibit showing the net worth computation for the petitioner and his wife (Ex. 183, R. 3612). This exhibit reflected the theory of the prosecution that all of the income of the enterprises should be allocated to petitioner. This was done upon instructions of the prosecuting attorney (R. 2870).

The amounts of partnership net worth, all of which was charged to petitioner in Ex. 183, are as follows:

	1944	*1945*
B-R Smoke Shoppe	$18,231.47	$23,344.66
Day-Nite Cigar Store	39,494.37	30,390.47
110 Eddy Club	39,998.52	44,321.40
Menlo Club		183,647.94
Total	$97,724.36	$281,704.47

In this manner the prosecution arrived at the conclusion that petitioner had understated his income as follows (Ex. 183, R. 3613):

	1944	*1945*
Total Income per Exhibit 183	$50,747.91	$71,065.40
Income Reported	19,000.00	59,318.36
Difference	31,474.91	11,747.04

The relationships between petitioner and his partners were evidenced by oral and written agreements. Prosecution witness, Kyne, had an interest in six different enterprises (R. 1493, 1496) including the four which are of pres-

ent importance here. A written agreement between Kyne and petitioner concerning the Menlo Club was introduced as Government Exhibit 113, R. 3582. A similar written agreement was made with witness Maundrell (Ex. 130, R. 3585) and other partners. There was also a written agreement concerning the Transit Smoke Shoppe, a later enterprise (R. 1189, 1523). Kyne testified that the oral agreements were similar in nature.

The written agreements deal with two different kinds of interest: An immediate "working interest" in the profits (R. 338) and an "actual interest" in the assets to be acquired by credits of undrawn profits (R. 1509). Because petitioner financed the enterprises, the arrangement contemplated that the shares of the profits of the other partners would be credited to their capital accounts until such time as the accumulated credits equalled their shares of the original investment and that petitioner's capital would be withdrawn in the same proportion as the other partners' earned credits. Witness Semenza, an accountant, testified that this is the usual practice in partnerships of a similar nature (R. 3388, 3423, 3433). With respect to the Menlo Club, for example, the equities of the various partners were credited with their working interests and charged with their withdrawals (R. 1807-8). Maundrell withdrew from the enterprise in 1948 and received all but $1700.00 of his equity in cash (R. 1807-10). Other partners drew on their accounts from time to time (R. 1833-5). The tax returns showed the distributive share of each partner and defendant's Ex. M-1 contained summaries of the partners' accounts (R. 3632, 3637, 3642). No ledger accounts were set up for the B-R Smoke Shoppe; the profits were divided between the partners at the end of each year. The other enterprises maintained regular books, with complete and detailed records of receipts and disbursements on a daily basis. The ledger posting was not up-to-date, but could readily be made current from the original records (R. 3275).

Petitioner spent little time around any of the enterprises (R. 1494). The other partners were active in the business (R. 1323, 1494). Cavani and Turner ran the 110 Eddy Club; Lando ran the B-R Smoke Shoppe; Maundrell was office manager for the Menlo Club, card room, bar, and restaurant (and also supervised the Day-Nite Cigar Store in Kyne's absence). Nelso, Ditto, Fricker, and Turner, who were also partners in the Menlo Club, had supervision of the various shifts in the 24-hour operation conducted there (R. 1330, 1385).

Petitioner did not participate in keeping the books (R. 1494-5). Public accountants were employed for that purpose. Lando was well known in the sporting and racing fraternity and his contribution to the partnership was his knowledge of the game and his ability to make prices (R. 1322-3). Kyne's working interest in the 110 Eddy Club was for services (R. 1382). He was the real manager of all of the enterprises (R. 1494).

With respect to the partnership issue, the instructions to the jury were as follows:

Instruction No. 24, R. 142:

> Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. Partnerships as such are not subject to income tax, but are required to make returns of income.
>
> A partner in a partnership shall include in his individual net income his share of the net income or loss of the partnership. If he draws either more or less than his share, his income tax is nevertheless based on the share to which he is entitled under the partnership agreement.

Instruction No. 28, R. 143, 144:

> Certain businesses were described in the income tax returns in evidence as partnerships. The law does not

prescribe any specific form of agreement as a requisite for partnership status. A partnership is an organization of two or more parties who have intended in good faith, and acting with a business purpose to join together in the present conduct of an enterprise. The arrangement between them may be either written or oral, and can be either an express or an implied agreement. It is not necessary that they contribute equal amounts of capital, or devote equal amounts of time to the business of the partnership, or have an equal share in the drawings, or have an equal right to draw money out of the business. The important question is whether the parties, including the defendant, actually had the intent in good faith to join together in operating the business as partners.

Petitioner's request for instructions dealing specifically with the "working interest" was denied (R. 83-4).

Proceedings Under Rules 16 and 17 of the Rules of Criminal Procdure.

The criminal indictment was filed on April 9, 1951 (R. 8). The case was set for trial on November 28, 1951 (R. 36). A motion for a bill of particulars was filed April 27, 1951, and denied June 15, 1951 (R. 10).

On November 13, 1951, petitioner filed a motion for a continuance (R. 16-17), and on November 14, 1951, a motion seeking a court order to inspect and take copies of certain books and records pursuant to the provisions of Rule 16, Federal Rules of Criminal Procedure. The records sought were described as "The books of account, journals, ledgers, cash books, expense books, vouchers and other records maintained by, or pertaining to the income and expense of" several named enterprises and any others from which the Government contends petitioner received income as an owner during the years 1944, 1945 and 1946. Supporting affidavits were filed with the motions (R. 20-34).

They recited that the Government had placed liens against petitioner's funds; that a certified public accountant who had assisted the petitioner prior to the indictment had withdrawn because of petitioner's inability to compensate him for his services (R. 49); that petitioner's tax counsel had become associated with the case in March, 1951; that in September, 1951, a certified public accountant had finally been engaged; that access to the records had been denied by the Government after the indictment, and that the records covered by the motion were material to the preparation of the defense.

The Government filed an affidavit in opposition (R. 35-41). This affidavit recited that certain records had been procured by the Government from third parties. (At the trial the third parties were identified as certain other partners in the enterprises (R. 2122-2126)). The affidavit in opposition to the motion also recited that prior to the indictment certain of the records had been turned over to an accountant for his use in behalf of the petitioner; that the accountant had turned them over to one of the petitioner's attorneys who continued to hold them and that the accountant had been unable to return them to the Government in accordance with his agreement. These latter records were subsequently deposited with the Clerk of the Court, pursuant to an order of the Trial Judge, and made available to both parties during the trial (R. 928-929, 1151). Petitioner's motion covered a considerable quantity of original records such as adding machine tapes, bank statements, cancelled checks, dealers' daily reports, etc. (R. 48). These were never made available to petitioner during the trial (R. 2717, 2771, 3250), although they were actually in the court house (R. 2451, 3483-6).

Both of petitioner's motions were denied (R. 42, 3492). The Court of Appeals held that prior opportunities which had been afforded petitioner's representatives to examine the material were sufficient (R. 3755), that the motion to inspect and take copies was not timely (R. 3756), and that

no specific showing of prejudice had been made (R. 3758).

Pursuant to Rule 17 of the Federal Rules of Criminal Procedure, petitioner filed a motion on November 23, 1951, together with supporting affidavits filed November 26, 1951, and procured a subpoena (R. 46-7) for production and inspection of books, papers, documents and objects (R. 42-54). The prosecution filed a motion to quash the subpoena, based upon the earlier affidavit (R. 55-58). The petitioner's motion was denied and the motion of the prosecution was granted (R. 58). The Court of Appeals sanctioned the denial of petitioner's motion because of the circumstances discussed in connection with the motions under Rule 16 (R. 3757). The Court of Appeals did not hold that compliance with the subpoena would have hampered the Government in any way.

Improper Communication With Jury

The verdict of the jury was returned on February 22, 1952 (R. 88). On February 24, 1952, certain stories appeared in California newspapers to the effect that during the trial the District Judge had enlisted the aid of the Federal Bureau of Investigation to investigate a remark made to one of the jurors at his home to the effect that money might be paid to the juror if he supported the defense (R. 114, 117). The defense had no prior knowledge of the incident (R. 112). A motion for new trial was filed on February 29, 1952 (R. 106) which included as Ground 17 (R. 109) the contention that the defendant had been substantially prejudiced and deprived of a fair trial by the incident. In addition, petitioner moved that there be a trial of the issue and that evidence be produced to adduce what had actually transpired. In support of Ground 17, an affidavit by petitioner's counsel was filed (R. 111) to which copies of the newspaper stories were attached. The affidavit alleged that the petitioner had been prejudiced by the incident and that the interests of justice required a trial of the issue (R. 112). The facts alleged in the affi-

davit were not challenged by opposing affidavits or by any remarks of the Trial Judge or the prosecuting attorneys. No hearing was held and no findings were made. The motion for new trial and the motion for a hearing for the purpose of developing the facts were denied without any comment (R. 93-94).

Treatment of Accounts Receivable as Cash

The evidence with respect to petitioner's taxable income on the net worth theory was summarized in prosecution Ex. 183 (R. 3612). Item 2 of that exhibit dealt with the B-R Smoke Shoppe and brought into the computation the results shown by Ex. 169 (R. 3601). The latter showed bank roll, cash on hand, at the end of 1945 to be $20,000. Exhibit 169 indicates that it was based on the testimony of Pritchett, a prosecution witness, and on Ex. 111-A. Pritchett testified (R. 1949) that the "cash" consisted of $15,000 of "markers" and only $5,000 in actual cash. The term "markers" was identified as meaning IOU's or Accounts Receivable which had not been paid (R. 1962, 1968). Pritchett's testimony dealt with the "markers" of customers and represented bets which had not been paid and which affected the business profits (R. 1965-1969). "Markers" representing the indebtedness of partners were considered as cash on settlements between the partners (R. 1734). Defendant's Exhibit M-1 omits the markers and shows cash on hand as $5,000 (R. 3628-9).

The only bank roll figure shown in Ex. 111-A was the amount as of January 1, 1943 (R. 2773). Exhibit 169 assumed, without any evidence to support it, that the bank roll remained the same at the end of 1943 and at the end of 1944 (R. 2773). Government witness Weaver testified that the result of his treatment of the markers was to increase the net worth of the business by $15,000 (R. 2781). He thought the markers represented cash advances, despite Pritchett's testimony (R. 2780). The Court of Appeals understood that the markers represented unpaid bets but

held that they were properly treated as cash because of its belief that they were collectible (R. 3769).

Weaver further testified that in preparing the net worth computation for the Menlo Club he had used "mostly" the cash receipts and disbursements method and that it was impossible to secure an accurate picture "by sticking to any one particular method specifically" (R. 2621). At another point Weaver testified that "there has actually arisen a sort of hybrid basis." (R. 2727).

SPECIFICATIONS OF ERROR

The Court of Appeals erred:

1. In holding that the tests for determining the recognition of a partnership for Federal income tax purposes as set forth in *Commissioner* v. *Culbertson*, 377 U.S. 733, are applicable in a criminal case, and that a failure of a defendant who has attempted to form partnerships to report all of the partnership income in his individual return is evidence of his willful intent to evade income taxes.

2. In not holding that the method of accounting employed by petitioner is capable of clearly reflecting the income; or in not holding that the applicable method of accounting and the defendant's true tax liability must be determined by the Commissioner of Internal Revenue.

3. In holding that the petitioner failed to keep adequate records which would clearly reflect income and that the net-worth method of proof was therefore permissible.

4. In holding that, despite the omission from a net-worth computation of a cash item which was known to exist at the beginning of the indictment period, the case could be submitted to the jury on the assumption that the difference between the opening net worth and the closing net worth represented taxable income received during the year.

5. In holding that the defendant had the burden of establishing the amount of the omitted cash item.

6. In holding that the Government's net-worth computation for a taxpayer on the cash basis properly includes accounts receivable.

7. In sanctioning the denial of petitioner's motions under Rules 16 and 17 of the Rules of Criminal Procedure.

8. In sanctioning the denial of petitioner's motion for a hearing to determine the facts of a reported incident during the trial involving one of the jurors and a third person.

9. In affirming the judgment of the District Court.

SUMMARY OF ARGUMENT

1. The tax returns involved were made on the basis of the cash receipts and disbursements method of accounting. The Government elected to prove its case solely by a net-worth computation. The only authority for departing from the method adopted by the taxpayer is found in Section 41, Internal Revenue Code. That section authorizes the Commissioner of Internal Revenue to select a different method (1) where no method has been regularly employed or (2) where the method employed does not clearly reflect the income. The term "method of accounting" refers to the general bookkeeping system as distinguished from the detailed entries of individual items in the books. Accordingly, errors or other inaccuracies in the books are not sufficient to invoke the authority under Section 41. Resort to a different method requires a preliminary determination by the Commissioner that one of the two conditions specified in Section 41 prevails. There was no such determination by the Commissioner in this case.

2. Instead, the Government contended that a departure from the cash receipts and disbursements method was

permissible because the taxpayer's books and records were inadequate in the sense that they were incomplete and inaccurate. The jury, instead of the Commissioner, was asked to determine the question of adequacy. We think that this construction of the statute is inadmissible and that the use of the net-worth method was not authorized.

However, even assuming that the Government's construction of the statute was correct, there was no sufficient showing of inadequacy here. All but one of the enterprises maintained regular books and there was no showing that the inadequacies could not be corrected from the original records. But all of the books and records were not in evidence and they were withheld from the petitioner despite his attempt to reach them through a motion for discovery and a subpoena for production. Entirely aside from the impropriety of submitting such a question to the jury, we submit that it could not properly make a determination of inadequate books under such circumstances. Moreover, it appears that in another proceeding the Commissioner of Internal Revenue has made a determination of petitioner's tax liability without departing from his method of accounting. We submit that this forecloses a departure from the taxpayer's method under Section 41.

3. Respondent's contention that the net-worth method is permissible as expert testimony, whether or not the preliminary determinations prescribed by Section 41, Internal Revenue Code, are made, necessarily assumes a construction of Section 145(b), Internal Revenue Code, which is quite inadmissible. That section must be read together with related sections and the offense for which it prescribes a penalty is the intentional failure to report the amount of tax imposed upon the true income, as shown by an official determination having the approval of the Commissioner of Internal Revenue. To construe Section 145(b) as authorizing criminal penalties upon the evidence of experts and in the absence of an official determination would raise serious questions concerning its validity.

4. But assuming, for the sake of argument, that the net-worth method was permissible, the computation offered in evidence by the Government was fatally defective in two respects. First, the starting point was not established. While the undisputed evidence showed that petitioner held cash at all times in safes and deposit boxes, the amount was unknown. Accordingly, the Government's computation gave him credit for none. With this gap in the proof, the assumption that new assets were acquired with new funds, which is essential to give meaning to the net-worth computation, could not be made. The Government had the burden of proof and could not shift to petitioner the obligation to produce affirmative evidence as to the amount of the starting cash.

5. Second, the Government's net-worth computation was erroneous because it included an amount of accounts receivable for the year 1945 which was in excess of the entire understatement of income charged to petitioner. The accounts receivable item consisted of promises to pay by customers who had lost bets. The Court of Appeals sanctioned the inclusion of the accounts receivable, apparently on the theory that the net-worth computation is a hybrid method and therefore it was not necessary to adhere to the cash receipts and disbursements method. Respondent does not attempt to support this theory, but argues that some unknown portion of the accounts receivable represented withdrawals by individual partners and was therefore properly included in the net-worth computation. The net-worth computation is, at best, an approximation, and the small understatement of income shown here leaves no room for inferences favorable to the prosecution after its failure to meet its burden of proof.

6. The paramount issue in this case was whether certain enterprises were partnerships as claimed by petitioner. The enterprises were jointly conducted with other individuals, who had real and substantial interests in the

profits; the oral and written partnership agreements provided that the other partners would leave their profits in the business until such time as their credits equalled petitioner's capital contribution, which was to be reduced annually. The other partners contributed services.

There was no evidence that the partnerships were a sham, but the Court of Appeals held that they could be disregarded under the rule of *Commissioner* v. *Culbertson*, 377 U.S. 733. That case was not decided until long after the taxable years here involved, and the recognition of partnerships is still a much litigated question. Accordingly, if the *Culberston* rule is to be applied, we submit that it is so uncertain that no layman can be assumed to know that his partnership will not be recognized. In such circumstances, criminal penalties may not be asserted.

Moreover, we submit that the question in a criminal case is not the question which the *Culbertson* case answers. The question here is not whether the partnerships should be recognized but whether they were unreal and a sham, so that petitioner knowingly and deliberately misrepresented their status when he claimed they were partnerships. The partners observed the agreements, built up their credits on the books, and withdrew some cash. In the absence of evidence that the partnerships were shams, no prima facie case was established.

7. Petitioner's motion under Rule 16, Federal Rules of Criminal Procedure, to inspect and take copies of certain of his own records was denied, and a subpoena issued under Rule 17, seeking the production of the same records, was quashed. The Court of Appeals sanctioned a harsh interpretation of the rules on the reasoning that sufficient prior opportunities to examine the material had been afforded petitioner, that his motions were not timely, and that no specific showing of prejudice had been made.

The principal purpose of the rules was to bring about fairness in the administration of criminal procedures and

since it appeared that the evidence sought was relevant and competent, and since no showing was made that the Government would have been hampered in any way, the motions should have been granted.

8. After the return of the verdict, certain newspaper stories were brought to the attention of petitioner's counsel, which stated that during the trial a third party had made a remark to one of the jurors at his home, to the effect that money might be paid to the juror if he supported the defense; that the district judge caused an investigation to be made by the Federal Bureau of Investigation and had concluded that the incident was harmless. The defense had not been notified of the investigation and had no knowledge of the incident until the appearances of the stories in the press. Petitioner thereupon filed a motion for a new trial, together with a request that a full hearing be held in order to make a record of what had actually transpired.

The trial court denied the motion without comment and no hearing was held. Accordingly, the Court of Appeals relied solely on the newspaper stories to answer petitioner's assignments of error on this point and to determine whether petitioner had been prejudiced. That court held that petitioner was required to show prejudice before he could have a hearing. This is contrary to the general rule that outside contacts with a jury raise a presumption of prejudice and we submit that such an important matter may not safely and fairly be left to the sole discretion of the trial judge, with no record upon which the defense or a reviewing court can form its own judgment of whether the incident was prejudicial.

ARGUMENT

I

It Was Not Permissible to Use the Net-Worth Method of Computation and, in Any Event, It Did Not Establish a Prima Facie Case.

Sec. 41 Requires Inadequacy of Method

The tax returns here involved were filed on the basis of the cash method of accounting. The prosecution did not rely on the discovery of any specific item of new income or any new source of income beyond those reported in the books or tax returns. The Government concedes (B. Op. 2) that the proof was based upon a computation of the annual increase in net worth.

The only authority for the use of the net-worth method of computation in criminal cases is found in Sec. 41, Internal Revenue Code. That section permits taxpayers to select "any method of accounting" which properly reflects their income. The Commissioner's authority to select a different "method" is limited to situations where (1) no method of accounting has been regularly employed, or (2) the method employed does not clearly reflect the income. This does not mean that the Commissioner is free to disregard the "method" merely because the books contain errors. *Thomas A. Talley* v. *Commissioner*, Tax Court Docket Nos. 33140, 33141, June 30, 1953, 20 T.C. , No. 101.

The meaning of the term "method of accounting" is not in doubt. As defined in the Treasury Regulations (Regulations 111, Sec. 29.41-2, p. 254) it means the basic system as distinguished from the detailed entries used in employing the system. The regulations include the following in the term:

Cash receipts and disbursements method
Accrual method
Basis of valuation employed in the computation of inventories
Long-term contract method

Percentage of completion basis
Completed contract basis
Crop basis.

The regulations are thus fairly consistent with this Court's construction of the term "basis of keeping accounts", which is found in the Revenue Act of 1916. In *United States* v. *American Can Company*, 280 U.S. 412, the quoted language was held to refer "to the general bookkeeping system followed by the taxpayer and not to the accuracy or propriety of mere individual items or entries upon the books." The taxpayer's selection of a method in his return constitutes an election which binds both him and the Commissioner and the selected method must be adhered to if it is capable of producing correct results. *Pacific National Company* v. *Welch*, 304 U.S. 191.

The Commissioner's authority under Section 41, Internal Revenue Code, gives him broad administrative discretion which is not reviewable by the courts in the absence of abuse. *Schramm, Receiver of First National Bank, Detroit,* v. *United States*, (CA 6) 118 F. 2d 541. Hence it would appear that Section 41 is never available without the Commissioner's authority.

In this case, there is no evidence that the Commissioner has made the preliminary determination required by Sec. 41 to the effect that the *method* selected by the petitioner is inadequate. Instead, the prosecution introduced evidence that the books were inadequate in the sense that they were incomplete or inaccurate. As shown by the *American Can* and *Pacific National* cases, supra, this is not a sufficient premise for the employment of the net-worth method.

Inadequacy of Books Not Shown

Moreover, aside from the erroneous premise, there was not a sufficient showing that the petitioner's books and records were inadequate. With one exception, all of the enterprises kept regular books and there was no showing

that the inadequacies could not be supplied from the original records. A large quantity of petitioner's original records was in the possession of the Government, the records were not introduced in evidence, and petitioner's attempts to reach them through a motion for discovery and a subpoena for production were unavailing. See Infra, pp. 41-45. Thus, with only a portion of petitioner's books and records in evidence, the jury was asked to determine whether his books and records were adequate. The instructions were not specific (R. 136-7, 145, 147-8) and the jury could not properly exercise the Commissioner's authority and determine the question of inadequacy. Petitioner was grievously prejudiced by the entire proceeding, even assuming that the Government correctly construed the statute as permitting the use of the net-worth method where the books are merely inadequate.

Respondent's Contention

In the Brief in Opposition, respondent contends in a footnote (fn. 7, B. Op. 25) that Section 41 has no application to criminal cases. This is a novel contention and is contrary to the decision of the court below (R. 3762). If the respondent means that the net-worth method of computation is not a "method of accounting" within the meaning of Section 41, then it is clear that the jury was improperly instructed otherwise (R. 136-7) and that the jury, the trial court and the Court of Appeals were misled into the belief that it was a method of accounting and into giving more weight to the computation than was justified. If the respondent means that the net-worth method of computation is admissible as expert testimony, and as the sole proof of the amount of tax due, without satisfying Sec. 41, then respondent must believe that Section 145(b) makes it a crime to file a return showing income in a smaller amount than some expert—any expert—testifies is due and owing. If upheld, such a contention would leave Section 145(b)

without any standard and make the crime it defines so uncertain that the validity of the statute would be brought into question.

However, we do not subscribe to the view that Congress has made it a crime to differ with the experts, and we do not agree that a prima facie case may be established by expert testimony alone. Section 145(b) must be read together with Sections 41, 51, 272 and 3612, Internal Revenue Code, and what it punishes is an attempted evasion of the tax on the true income, as shown by an official determination having the approval of the Commissioner.

Section 145(b), Internal Revenue Code, under which this prosecution arose, prescribes punishment for a willful attempt in any manner to evade and defeat "any tax imposed by this Chapter". Each count of the indictment (R. 3-8) charged an attempt to defeat and evade a large part of the income tax due and owing, stated in dollars. There is no statute which prescribes the dollar amount of petitioner's tax liability. Thus, the question is, How is "any tax imposed by this Chapter" to be translated into dollars? The complicated statutory provisions for ascertaining tax liability, which are supplemented by equally complicated administrative regulations, have given rise to endless disputes and litigation. The true tax liability is such a controversial question that administration of the law would have been impossible unless Congress had prescribed a definite method for determining the amount of "any tax imposed by this Chapter".

The question which Section 145(b) raises is resolved by the related sections. Section 41, Internal Revenue Code, provides that the net income "shall be computed" in accordance with the method of accounting regularly employed in keeping the books, but that under certain circumstances the Commissioner may require that the computation be made in accordance with a different method. Section 51, Internal Revenue Code, provides that every individual

subject to tax shall make a return, presumably in accordance with his books. Section 3612, Internal Revenue Code, provides that if any person makes a false and fraudulent return, then the Collector shall make a substitute return. Section 3612(c) provides that any substitute return made by the Collector and *approved by the Commissioner* "shall be prima facie good and sufficient for all legal purposes." Section 3612, Internal Revenue Code, is made applicable to income taxes by Section 61, Internal Revenue Code.

Accordingly, it would seem to be clear that in a prosecution under Section 145(b) the amount of "tax imposed" which the defendant is charged with evading and defeating should be established by a substitute return made under the authority of Section 3612. The statute does not leave the amount of tax disclosed by the substitute return to the individual determination of the Collector; his determination is subject to the approval of the Commissioner. Thus, an attempt to defeat and evade a portion of the tax shown by a determination in the form of a return bearing the approval of the Commissioner is the offense for which Section 145(b) prescribes punishment.

No civil claim for a deficiency in income tax is authorized without the approval of the Commissioner of Internal Revenue (Sec. 272, Int. Rev. Code) and it is inconceivable that Congress would authorize a criminal prosecution without a similar supporting determination by the Commissioner. Possibly a deficiency determination under Section 272, satisfies the requirements of Section 3612. However, the statute clearly does not prescribe punishment for failing to return and pay the amount of tax computed to be due by a subordinate of the Commissioner of Internal Revenue, under the domination of the chief Government prosecutor (R. 2869-2885), which was the situation in this case.

In lieu of the prescribed official determination, a net-worth computation prepared during the course of the trial by a technical advisor of the Bureau of Internal Revenue

(R. 2840) was relied on here (Ex. 183, R. 2852-3, 2856, 3612-13), and the same witness testified to the tax liability (R. 2860-2865). The jury was instructed to consider this as expert testimony (R. 147-8). The Government elected to treat the net-worth computation as a "method" and we submit that it was not permissible to use it without the sanction of the Commissioner, as required by the Internal Revenue Code.

The need for a strict adherence to the procedure prescribed for proving a defendant's tax liability is dramatically shown in this case by the fact that the Commissioner disagrees with his subordinate and with the theory on which the unofficial computation (Ex. 183) was based. The net-worth computation attributed all of the income from the various enterprises to the petitioner on the theory that they were his sole proprietorships and not partnerships as reported in the various tax returns (R. 2867, 2869). The Commissioner has repudiated this theory in an official deficiency letter which recognizes that petitioner is entitled to report only his individual share of the partnership income. An appeal from the Commissioner's determination in the deficiency letter is pending before the Tax Court. *Remmer* v. *Commissioner*, Docket No. 23486. In the determination of the civil liability, the Commissioner did not depart from the petitioner's method of accounting. Thus, it is apparent that the finding of unacceptability of the taxpayer's method, which is a pre-requisite under Section 41, is not only completely lacking, but that such a finding is foreclosed by the deficiency letter, if the *Schramm* case, supra, is correct. Accordingly, the net-worth computation was unauthorized and the Government did not make out a prima facie case.

Moreover, the use of expert testimony to show the results of a net-worth computation as the sole proof to sustain a charge that a taxpayer using the cash basis of accounting has understated his income tax for a particular year in-

volves a basic fallacy. It is obvious that different methods of accounting will produce different amounts of income, or at least will distribute the income differently throughout the taxable years. Accordingly, we submit that it is fallacious to assume that evidence of the income computed on a different basis than that actually employed by the taxpayer shows the income which he knew he was under a duty to report. The amount shown on any substitute basis is meaningless by itself and does not support an indictment under Section 145(b). This is particularly true of the net-worth method. A net-worth computation is evidence of the taxpayer's spending in particular years, but it does not purport to give any positive indication of whether the funds represent income, or when the income was derived. Those vital ingredients of a prima facie case are left entirely to assumption, and of course, the taxpayer could not have foreseen the result of the computation.

The net-worth method may serve a limited purpose where there is other evidence indicating that the taxpayer had specific sources of income which he has failed to disclose. Such a use of the net-worth method as "reinforcement" was approved by the Court in *United States* v. *Johnson*, 319 U.S. 503. We submit, however, that the net-worth method was misapplied in this case. That view is consistent with a recent official statement of the Commissioner of Internal Revenue. Reference is respectfully made to the Reply Brief for Petitioner, pp. 6-7.

Starting Point

Furthermore, even if the situation warranted the use of the net-worth method, the computation (Ex. 183) was fatally defective because the net worth at the beginning of the indictment period was not definitely established.

The net-worth computation reflects known assets and cash outlays which have been made to procure or improve the assets on hand at the end of the year (R. 2555). All

such cash outlays are treated as newly acquired assets. No attempt is made to identify the source of the funds used to make the outlays, nor the year in which the funds became available to the taxpayer. The year in which the outlay was made is assumed to be the year in which the funds became available. In this manner, a showing is made that at the beginning of each year the defendant's assets were worth a specific sum and that at the end of the year his assets were worth a greater sum. The difference is then adjusted for any funds received as gifts, loans, inheritances, etc., for taxes paid and for living expenses. The adjustment for gifts, loans, inheritances, etc. is a deduction, which is made only if the Government can find any such receipts. If the Government fails to find any gifts, loans, or inheritances, it assumes that there were none. The burden is then cast on the defendant to show that there were such items which the Government failed to discover. Taxes and living expenses are assumed to have been financed from receipts of the current year. After making the aforesaid adjustments, the resulting figure is assumed to be taxable income. The jury was so charged (R. 137-8). The year in which the outlays were made is thus assumed to identify the year in which the income was received. In Exhibit 183, all of these assumptions were made by the party having the burden of proof.

The crudeness of the method and the assumptions which are required to be made in order to give any meaning to the results, have caused some judicial qualms about the propriety of submitting such evidence to juries. The senior circuit judge of the Fifth Circuit has recently pointed out that the proof of a criminal case by reliance on the net-worth method is fraught with danger of violation of the defendant's constitutional rights. In *Demetree* v. *United States*, decided November 24, 1953, not yet reported (See 53-2 U.S.T.C. 9646) the court said:

> This is another of the growing list of criminal cases in which the government, having no or little

direct evidence of defendant's guilt to offer and endeavoring to prove it by circumstantial evidence, attempts to do so by what may be called the net worth and expenditures method of proof. In this attempt, unless the greatest care is taken by the district judge to prevent it, there is danger of the case being tried on a theory which, keeping to the ear the promise that a defendant is presumed innocent until his guilt is established beyond a reasonable doubt, breaks it to the hope by allowing a series of theoretical estimates and computations as to defendant's income to take the place of proof of it.

Sometimes conclusions from those computations and estimates are allowed to invade the province of the jury and furnish the basis for a conviction not upon evidence of facts but upon speculation and theorizing by the government's witnesses as to what the facts really are.

Sometimes, without adhering to the essentials of the method, that the net worth at the beginning as well as the end of the period be shown, the proof comes in and the case is submitted with a complete gap in the proof as to the beginning of the period.

This kind of latitudinous allowance of the admission and use of conclusions as evidence and the submission of the case to the jury without a scrupulous adherence to the theory has resulted in a tendency to accept, if not in the complete acceptance of, the idea that in a case tried by this method, ordinary rules of proof may be relaxed if not disregarded. Further and more prejudicial to a defendant, there has grown up a kind of ancillary theory that the government by introducing proof of deposits, expenditures, etc., having put up what it calls a *prima facie* case, the defendant finds himself jockeyed out of the position the law affords him, of insisting that the government establish his guilt by legal and credible evidence beyond a reasonable doubt. This is accomplished by requiring him to prove himself innocent by assuming the burden of overcoming the prejudicial effect of the mass of exhibits, estimates, conjectures, and conclusions which the government has been allowed to get into the record, upon the apparent theory that it is up to the defendant

to explain all of it away as part of his burden to prove his innocence.

This court and other courts have, in many cases,[2] pointed out the dangers attending trials conducted in this way. Some of them have at times seemed to be more concerned with easing the difficulties attending the proof of guilt by this method than with preserving unimpaired the constitutional rights of a defendant, the fundamental safeguards and guarantees of his liberty. Most of the courts, however, confronted with the situation which this kind of case presents, have withstood all attacks upon, and have held fast to, constitutional principles, including the fundamental premise upon which criminal trials proceed, that the defendant is presumed innocent until his guilt is established by legal and admissible evidence beyond a reasonable doubt.

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[2] *Bryan* v. *United States,* 175 Fed. (2d) 223 (49-1 USTC Par. 9322); *Fenwick* v. *United States,* 177 Fed. (2d) 488 (49-2 USTC Par. 9448); *United States* v. *Caserta,* 199 Fed. (2d) 905 (52-2 USTC Par. 9540); *Pollock* v. *United States,* 202 Fed. (2d) 281 (53-1 USTC Par. 9229); *Montgomery* v. *United States,* 203 Fed. (2d) at 892 (53-1 USTC Par. 9336). Cf. *U.S.* v. *Johnson,* 319 U.S. 503 (43-1 USTC Par. 9470).

The courts have been particularly zealous to insist that the starting point in a net-worth computation must be based upon a solid foundation. *United States* v. *Chapman,* 168 F. 2d 977, 1001 (CA 7); *United States* v. *George L. Smith,* 206 F. 2d 905 (CA 3); *Bryan* v. *United States,* 175 F. 2d 223 (CA 5); *United States* v. *Fenwick,* 177 F. 2d 488 (CA 7).

In the *Bryan* and *Fenwick* cases, supra, it was held that where the prosecution attempts to establish an understatement of income by the net-worth method, the case should not be submitted to the jury if the starting point net worth is not definitely established because the evidence is not sufficient to make out a prima facie case. These cases were recently cited with approval by the court below, where the bench consisted of Judges Denman, Healy and Bone. *Calderon* v. *United States,* 207 F. 2d 377. In civil

fraud cases the Tax Court follows a similar practice. *King Tsak Kwong* v. *Commissioner,* Docket 27019, decided October 7, 1953, CCH Decision No. 19,924(M); *James Q. Whittemore* v. *Commissioner,* Docket No. 13421, 7 T.C.M. 845, 849.

The importance of a precise starting point in a computation by the net-worth method is that, without it, the hypothesis remains that some or all of what appear to be new assets were actually acquired in exchange for old assets or with cash received in earlier years. Thus, the assumption that the difference between the amount of assets at the beginning and end of a particular year constitutes taxable income realized in that year, cannot be made. Without that assumption, the net-worth computation is meaningless.

The starting point was not fixed in this case because the undisputed evidence introduced by the prosecution showed that the petitioner held cash in safes and deposit boxes at all times (T. 1268, 1484, 1535, 1536, 2956), but there was no evidence as to the amount. In the net-worth computation (Ex. 183, R. 3612) Line 25 is marked "cash in safe deposit boxes", but no figures are shown which effect the computation. Instead of figures, the column listing the assets for each year shows an interrogation mark. Thus, the net-worth computation conceded the existence of cash at the beginning of the indictment period and also the Government's inability to determine the amount. From such evidence it seems clear that no reasonable mind could conclude that the new assets shown by the net-worth statement were actually paid for with newly acquired funds, and that such funds could be assumed to constitute taxable income of the indictment years. Accordingly, the Government failed to make out a prima facie case.

Petitioner objected to the introduction of Exhibit 183 (R. 515-538, 2856-2857) and moved for judgment of acquittal on the ground that the use of the net-worth method was not available to the prosecution because of lack of evidence as to the starting point (R. 3465, 3477). The mo-

tion was denied (R. 3469). The instructions to the jury on the point were inadequate (R. 136-138), and the petitioner's request for other instructions was denied (R. 79-83).

The Court of Appeals declined to follow the decisions in the *Bryan* and *Fenwick* cases (R. 3766). It expressed the view (R. 3765) that the Government would be frustrated in its attempt to enforce the tax evasion provisions of the Internal Revenue Code if net-worth cases were withdrawn from juries because of mere statements that defendants had additional undisclosed assets. This view merits the comment made in the *Demetree* case that some courts have appeared to be more concerned with easing the difficulties attending the proof of guilt by the net-worth method, than with preserving the constitutional rights of a defendant. Moreover, the situation here is not comparable to the extreme case which the court below had in mind. The existence of the cash did not depend on the acceptance of defendant's claims. It was shown by a prosecution witness (R. 1483-4); there was no evidence to the contrary and the Government conceded in Line 25 of Exhibit 183 that an unknown amount of cash was in the petitioner's possession at the beginning of the indictment period. The comment of the court below (R. 3765) that petitioner "did not attempt in any way at the trial to prove that substantial funds were in fact kept in the box" indicates an erroneous conception of the burden of proof. We submit that petitioner did not have the burden of establishing the amount of the omitted cash item.

The suggestion of the court below (R. 3765) that an unpaid $1800 judgment outstanding on the critical date tended to show that petitioner did not have any substantial amount of cash, overlooks the fact that petitioner had much more than this amount in the bank (Ex. 183, R. 3589; Ex. 169, R. 3601).

Markers

The net-worth computation (Ex. 183) was further fatally

defective in that it erroneously included both cash and accrual items. It is well settled that the cash and accrual systems of accounting are distinct, and that each system should be employed to the exclusion of the other. It is not permissible to use them both at the same time. Sec. 29.41-2, Treas. Regs. 111, provides: "A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency."

Nevertheless, the Court of Appeals has sanctioned a departure from this principle (R. 3769), apparently on the theory that the net-worth system is a hybrid method of computation. A prosecution witness testified that he had used "mostly" the cash receipt and disbursements method, and that it was impossible to secure an accurate picture "by sticking to any one particular method specifically" (R. 2621). He thought "there has actually arisen a sort of hybrid basis" (R. 2777). Keeping in mind that the prosecution was attempting to show fraud on the part of a taxpayer whose accounts were maintained on the cash receipts and disbursements system, it is somewhat startling to have a judicial indication that such a taxpayer may be punished for not reporting the amount of tax shown to be due by a method of computation which treats promises to pay as cash.

In this case, the promises to pay consisted of so-called "markers" which represented the amount of credit extended to customers. The markers were unpaid bets. They were not identified as such in the Government's exhibits. They were included in an item entered on Exhibit 169 (R. 3601) for the year 1945 as "cash on hand—bankroll—Ex. 111-A, Pritchitt's test.—$20,000". The markers are included in Exhibit 183 (R. 3612) under Item 2 which reflects the net-worth results computed in Exhibit 169.

Turning to Pritchett's testimony (R. 1949, 1962, 1968), it appears that the cash was only $5,000 and that the other $15,000 represented markers. The witness Kyne explained that the markers indicated unpaid bets, sometimes taken

over the telephone and not represented by any note or other document (R. 1361). Markers were also used to indicate withdrawals by the partners (R. 1299, 1374-5). Markers of this kind were disposed of on settlement at the end of each year. They were considered as cash already distributed to the partner responsible for the marker. Pritchett's testimony dealt with customers' markers which, if not paid, would have affected profits (R. 1968). When such markers were paid, the cash on hand was increased (R. 1360). This was the understanding of the court below (R. 3769).

We submit that the markers should have been excluded from Exhibit 183 in the computation for the year 1945. For that year, the prosecution contended that petitioner understated income in the amount of $11,747.04 (R. 3613). Accordingly, if Exhibit 183 had adhered to the cash receipts and disbursements method, and reflected only cash receipts, and omitted the promises to pay in the amount of $15,000, the evidence would have shown no understatement of income whatever.

The Brief in Opposition does not attempt to support the use of the hybrid method sanctioned by the court below. If there was any confusion in the testimony concerning the nature of the $15,000 markers, as suggested by respondent (B. Op. 28), it was an error to admit Exhibit 183 in evidence. The net-worth computation, at best, is an approximation, and where it indicates only a small understatement there is no room for permitting the jury to indulge in the inferences suggested by respondent. Moreover, the jury had no reason to make such inferences in view of the instructions (R. 137-8).

II

The Form of the Enterprises Was Not a Sham and Partnership Issue Should Not Have Been Submitted to the Jury.

As shown by the statement of facts, petitioner's returns disclosed the receipt of income from various enterprises, and those enterprises filed partnership returns, disclosing

that petitioner was liable for his share of the income. The Government contended that four of the partnerships should not be recognized for tax purposes and that petitioner was therefore liable to criminal penalties because he had not reported all of the income individually. This was the paramount issue.

The prosecution recognized two of the six enterprises as partnerships (21 Club and San Diego Social Club) (R. 893-4) and the jury failed to convict on the counts dealing with the year 1946, for which partnership returns were also filed. The written partnership agreements were drawn in 1946 but related back. (R. 3582-5) Presumably, this is what distinguished 1946 in the eyes of the jury. The 186 Club was eliminated from the partnership issue because the Government recognized it as a corporation. Notwithstanding the uncertain legal status of the enterprises, petitioner has been found guilty of tax evasion on the presumption that he willfully and knowingly failed to report all of the income of the enterprises on his individual returns. The records of the Tax Court show that an official deficiency letter was issued on May 6, 1949, in which the 186 Club and all other enterprises were recognized as partnerships. *Remmer* v. *Commissioner,* Docket No. 23486.

The Court of Appeals held (R. 3768) that the tests of liability for partnership income laid down in *Commissioner* v. *Culbertson,* 377 U.S. 733, 742, were applicable and that the question was one of fact for the jury. The *Culbertson* case was a civil case and this Court held that the question was one of fact for the Tax Court, the experts.

Moreover, the *Culbertson* case was decided in 1949. Accordingly, it was not available to petitioner in 1945 and 1946, when he is alleged to have committed the offenses upon which he was convicted. In 1949 the law was so changed that earlier decisions are not recognized as *res judicata. Joe Lynch* v. *Commissioner,* Tax Court Docket No. 24859, 20 T.C. —— No. 146, September 23, 1953, CCH Decision 19,901. But even if the tests applicable in civil

cases are likewise to be applied in criminal cases, the tests are not sufficiently well understood that knowledge of the correct conclusion could safely be attributed to every layman.

The earlier cases in this field, *Commissioner* v. *Tower*, 327 U.S. 280, and *Lusthaus* v. *Commissioner*, 327 U.S. 293, were decided on February 21, 1946, about the time when the latest alleged offense of the petitioner occurred. These cases were rather widely misinterpreted by taxpayers and by the Courts (See *Trapp* v. *Jones*, (W.D. Okla.) 87 Fed. Supp. 415; *Spies, et al.* v. *United States*, (N.D. Iowa) 84 Fed. Supp. 769). Even the Justices of this Court were not in agreement in the *Culbertson* case as to what tests should be applied, nor as to the proper conclusion to be drawn in that particular case. The decision did not completely clarify the situation and the courts have been flooded with litigation ever since. The proceedings following this Court's remand of the *Culbertson* case are illuminating. Both courts attempted to apply the *Culbertson* decision, but they reached different conclusions. The Tax Court decision rendered on the remand, 9 T.C.M. 647, was reversed by the Court of Appeals, 194 F. 2d 581 (CA 5). It is not an overstatement to say that the tests for determining the civil liability are still uncertain and it is a new departure in the law to hold a taxpayer liable for criminal penalties when he mistakenly claims that his income should be computed on the partnership basis.

The Senate Finance Committee report on H.R. 4473, Proposed Revenue Act of 1951, discloses the then current confusion with respect to the recognition of partnerships for tax purposes. In 1952, the Bureau of Internal Revenue published a ruling outlining the Bureau's position with respect to recognition of partnerships for years prior to 1951, Mim. 6767, Cumulative Bulletin 1952-1, p. 111. A current ruling states that "the term 'partnerships' for tax purposes is broader than the term under common law, the Uniform Partnership Act, or individual State laws." Rev. Rul. 144,

Internal Revenue Bulletin No. 16, Aug. 3, 1953, p. 29. The Government has attempted to require some partnerships to file corporate returns on the theory that they are associations. (*The Olmsted Hotel* v. *Commissioner,* Tax Court Docket 28375, 11 T.C.M. 694).

Today the tax liability for partnership income is one of the most prolific sources of litigation. A recent analysis of cases on the Tax Court docket for the period November 8, 1951 to January 19, 1953, shows over one thousand disputes in the partnership field (1953 Commerce Clearing House, Par. 8637). In such cases the question usually is whether the taxpayer is correct in his conclusion that he is liable for only a portion of the partnership income. This is a criminal case, but if it presents only the same question as the civil cases, any of the taxpayers in the thousand Tax Court cases would likewise be liable to criminal prosecution. If it be the law that the civil tests are applicable in criminal cases, any taxpayer who claims to be a partner may be indicted if the Bureau disagrees. If the Government really believes that the same tests apply, the dearth of reported criminal cases is difficult to explain.

However, we submit that the question in a criminal case is not the same as in a civil case. The offense of tax evasion requires, first, a knowledge that certain omitted income should be included in the tax return. The question here is whether petitioner knew that he had not created a partnership (or a syndicate, pool, joint venture, etc.), and knowingly misrepresented that he had. Where, as here, a taxpayer joins with others in the conduct of certain enterprises, his liability to include all of the income in his individual return is so uncertain that there is no basis on which a jury could properly convict him of knowingly and willfully failing to report the entire partnership income with intent to defraud the revenue.

In a recent civil case where the Commissioner asserted fraud penalties because of his refusal to recognize the taxpayer's claimed partnership, the Tax Court agreed that

the partnership should not be recognized for tax purposes, but it declined to approve the fraud penalties even though it held, on the authority of the *Culbertson decision* (p. 903), that "the parties did not in good faith intend to become partners for the operation of the business." (*C. C. Cooke* v. *Commissioner*, 10 T.C.M. 881). The Court of Appeals for the Tenth Circuit reversed the Tax Court and held that for some of the years involved the partnership should be recognized, 203 F. 2d 258. It did not disturb the Tax Court decision with respect to the fraud penalties and apparently the Commissioner did not file any appeal on that issue. Certiorari was denied in the *Cooke* case, Docket No. 77, October Term, 1953.

In the case at bar, the jury was instructed (R. 144) that "The important question is whether the parties, including the defendant, actually had the intent in good faith to join together in operating the business as partners." In the *Cooke* case, *supra*, the Tax Court held that such a finding will not support even a civil fraud penalty. The jury was also instructed that the partnership must serve a business purpose (R. 143), and the Court of Appeals agreed that the applicable tests include that concept (R. 3678). We submit that the Court of Appeals has sanctioned an erroneous test and has mistakenly applied the civil rule in a criminal case.

While the trial court covered the question of intent in a general charge (R. 134-5), the denial of petitioner's requested instructions Nos. 69, 75, 77, 78, 79, 80, 81, 82, 88, 89, and 90 (R. 73-79) left the jury free to determine the partnership issue by applying the civil rule.

There was no basis upon which the jury could properly have found that petitioner never intended to form partnerships. The trial court insisted that the question whether the partnerships were real should be left to the jury, despite petitioner's contention that there was no reasonable basis upon which the jury could infer otherwise (R. 3480).

The enterprises were conducted on a profit-sharing basis,

the individual partners' equities were carried on the books, (R. 3287) the other partners performed services, and petitioner supplied the cash. A distinction was made between the interests of the partners in the profits and their interests in the assets, (R. 338, 1509) but that is customary and does not militate against the existence of valid partnerships, nor indicate that the partnerships were a sham. The credits for the other partners reduced petitioner's interest in the partnership capital, and the prosecuting attorney conceded that Maundrell, one of the partners, was "entitled" to his $15,000-$17,000 credits after petitioner recovered his capital (R. 538). If Maundrell was entitled to take out of the business the credits which accumulated during the indictment years, it is plain that his share of the annual earnings was real and substantial and the fact that it remained in the business is of no consequence.

The Government's peculiar theory that the other partners should be recognized at some later time (R. 538) evidently prevailed with the jury, although, unlike the Government, the jury was willing to recognize the partnerships for the year 1946, after the partnership agreements had been formalized by written instruments. However, these circumstances go to the question of the validity of the partnerships; they do not bear on the question of the petitioner's intent. Here there was an agreement between petitioner and others to conduct enterprises jointly. We submit that the details are not so important as the fact that the agreements were carried out and that the others acquired interests in the profits of the business which were recorded in the books and resulted in reducing petitioner's capital interest. The contention that petitioner attempted to defraud the Government by claiming that his proportionate share of the income was reduced by the arrangement is erroneous as a matter of law. We submit that it is not attempted evasion for a taxpayer to claim that his plan has been successful. If it were otherwise, no taxpayer could contend for and act upon a plausible construction of

the technical statutory provisions of the Internal Revenue Code and escape criminal penalties if his construction proved to be erroneous.

There is nothing in the record to support the necessary conclusion that the partnership agreements were empty gestures and that petitioner did not intend and attempt to form partnerships. Moreover, the partnerships were recognized by the Commissioner of Internal Revenue for all of the indictment years, *Remmer* v. *Commissioner,* Tax Court Docket 23486, and the fact that this indictment occurred is evidence of administrative confusion. The jury was also confused by the legal technicalities and the instructions of the trial court, with the result that it brought in a verdict which has no support in the record.

Respondent apparently believes that a taxpayer who actually conducts an enterprise jointly with other individuals in the form of a partnership will be subject to criminal penalties if his purpose was to evade taxes. (B. Op. 30-31). This reasoning confuses avoidance with evasion. We understand that evasion involves a misrepresentation of what was actually done, no matter what the purpose of the act, nor whether the attempt was successful. Where the form is not a sham, we submit that no evasion can result from merely doing business in a particular form and reporting the tax liability applicable to that form. It is well settled that taxpayers are free to choose the form in which they will conduct their enterprises and that their civil liabilities will not be affected even though they deliberately select the form which results in tax reduction. Congress makes tax liabilities depend on the manner in which business transactions are carried out, and taxpayers are free to avail themselves of the opportunity to reduce their taxes by adopting the particular form of transaction or business organization which will qualify for the tax savings.

The legal right of a taxpayer to reduce his tax liability, by any means which the law permits, is firmly established:

United States v. *Isham*, 17 Wall. 496
Gregory v. *Helvering*, 293 U.S. 465, 469
Commissioner v. *Tower*, 327 U.S. 280

In the *Tower* case, supra, it was held that the principle

> * * * would clearly apply, for example, in a situation where a member of a partnership, in order to keep from paying future taxes on partnership profits and in order to get into a lower income tax bracket sells his interest to a stranger, relinquishing all control of the business. But the situation is different where the taxpayer draws a paper purporting to sell his partnership interest even to a stranger, though actually he continues to control the business to the extent he had before the "sale" and channels the income to his wife. * * *

In other words, the rule is that a purpose to reduce taxes does not effect the question of tax liability, unless it is established that the partnership form was only a sham. The rule was thus stated in *Chisholm* v. *Commissioner*, 79 Fed. 2d 14 (CA 2), certiorari denied 296 U.S. 641:

> * * * The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance. True, it is always the intent that controls; and we need not for this occasion press the difference between intent and purpose. We may assume that purpose may be the touchstone, but the purpose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation which the apparent, but not the whole, transaction would realize. * * *

Here all of the partners in the enterprises had substantial rights and interests in the profits and the partnership form was not a sham.

We submit that the civil tests for the recognition of partnerships are not applicable in criminal cases; that if such tests are applicable there is a wide difference of opinion as to their meaning; that a taxpayer's claim of even a doubtful partnership status cannot properly be made the basis of a criminal charge; and that there was no evidence here from which the jury could properly conclude that the purported partnerships were unreal.

III

Petitioner's Motions Were Consistent With the Purpose of Rules 16 and 17, Federal Rules of Criminal Procedure.

Proceeding under Rule 16 of the Federal Rules of Criminal Procedure, petitioner filed a motion after the finding of the indictment, to inspect and take copies of certain books, papers, documents and tangible objects, which were described (R. 19-20). Supporting affidavits filed with the motion (R. 20-34) recited the circumstances which made the motion necessary and explained the delay. An affidavit in opposition was filed by the prosecution, urging that the motion be denied on the ground that ample opportunity to prepare his case had already been afforded the defendant (R. 35-41). The motion was denied by the trial court. The Court of Appeals sanctioned this action on the reasoning that sufficient prior opportunities to examine the material had been given (R. 3755), that the motion was not timely (R. 3756), and that no specific showing of prejudice had been made (R. 3758).

Rule 16 provides for such motions "at any time after the filing of the indictment or information" and it does not appear that the time element was a factor to be considered. At any rate, the Government had contributed to the delay and the time element was not a sufficient reason for denying the motion even if the rule itself does not foreclose it. Petitioner made unsuccessful attempts to secure the release from Federal lien of sufficient assets to finance his defense

(R. 20-25), and much time was consumed in unavailing efforts to arrange for inspection of the records without a court order (R. 25-34, 166). The Government made unwarranted and impossible demands as the price of its consent (R. 29-30, 41). The Government sought a net-worth statement (R. 38, 50-54), and a showing of petitioner's "interest" in the enterprises (R. 27, 30, 33, 166, 185). The Government recognized petitioner's need for the records by bargaining with him for evidence which would bolster the Government's case. It made its conditions one at a time, and finally drove petitioner to a last-resort motion for a court order. The Government then took the position that petitioner did not really need the records and secured a denial of the motion on the ground that the trial date was only two weeks away. The trial lasted three months, petitioner made repeated efforts to have access to the records (R. 928-9), and the records sought were actually in the courthouse (R. 2451, 2771).

Petitioner showed that the prior opportunities to examine the records had occurred before the time when petitioner's tax counsel was engaged (R. 22, 32). It was not unreasonable to anticipate that an examination of the records under his direction would develop additional defense material, particularly in the light of the Government's announced reliance on the net-worth method. We submit that there was a reasonable showing that an examination of the records would be beneficial to petitioner and it does not appear that the rule authorizes the court to substitute its own judgment on that matter.

Bearing in mind that the Government contended that the books and records were inadequate as a basis for the net-worth computation, it seems plain that the suppression of a mass of original documents, of sufficient bulk to fill a packing box of approximately fifty cubic feet, plus several other smaller cartons (R. 48), was prejudicial to petitioner. The impressive quantity of records was in itself a matter of consequence, and we submit that the rule was improperly

interpreted by the Court of Appeals to require that the need for specific papers be shown (R. 37-58). The result of denying the benefit of the rule here was to permit the Goverment to withhold records and then submit to the jury the question of whether the partial records in evidence were adequate. It is submitted that this procedure violated the spirit of the rule as interpreted in *Bowman Dairy Co.* v. *United States,* 341 U.S. 214, 218-220.

Petitioner also sought a subpoena for production of the records, which was quashed. Rule 17 provides that the grounds for quashing subpoenas are that compliance would be (a) unreasonable or (b) oppressive. There was no suggestion here that production of the records would have hampered the Government in any way and the grounds for quashing the subpoena do not satisfy the requirements of Rule 17.

In *Bowman Dairy Co.* v. *United States,* supra, the court said:

(pp. 218-220):

> It was intended by the rules to give some measure of discovery. Rule 16 was adopted for that purpose. It gave discovery as to documents and other materials otherwise beyond the reach of the defendant which, as in the instant case, might be numerous and difficult to identify. The rule was to apply not only to documents and other materials belonging to the defendant, but also to those belonging to others which had been obtained by seizure or process. This was a departure from what had theretofore been allowed in criminal cases.
>
> Rule 16 deals with documents and other materials that are in the possession of the Government and provides how they may be made available to the defendant for his information. In the interest of orderly procedure in the handling of books, papers, documents and objects in the custody of the Government accumulated in the course of an investigation and subpoenaed for use before the grand jury and on the trial, it was provided by Rule 16 that the court

could order such materials made available to the defendant for inspection and copying or photographing. In that way, the control and possession of the Government is not disturbed. Rule 16 provides the only way the defendant can reach such materials so as to inform himself.

But if such materials or any part of them are not put in evidence by the Government, the defendant may subpoena them under Rule 17 (c) and use them himself. It would be strange indeed if the defendant discovered some evidence by the use of Rule 16 which the Government was not going to introduce and yet could not require its production by Rule 17 (c). There may be documents and other materials in the possession of the Government not subject to Rule 16. No good reason appears to us why they may not be reached by subpoena under Rule 17 (c) as long as they are evidentiary. That is not to say that the materials thus subpoenaed must actually be used in evidence. It is only required that a good-faith effort be made to obtain evidence. The court may control the use of Rule 17 (c) to that end by its power to rule on motions to quash or modify.

(pp. 220-221):

* * * Rule 17 (c) was not intended to provide an additional means of discovery. Its chief innovation was to expedite the trial by providing a time and place *before* trial for the inspection of the subpoenaed materials. *United States* v. *Maryland & Virginia Milk Producers Assn.*, 9 F.R.D. 509. However, the plain words of the Rule are not to be ignored. They must be given their ordinary meaning to carry out the purpose of establishing a more liberal policy for the production, inspection and use of materials at the trial. There was no intention to exclude from the reach of process of the defendant any material that had been used before the grand jury or could be used at the trial. In short, any document or other materials, admissible as evidence, obtained by the Government by solicitation or voluntarily from third persons is subject to subpoena. * * *

The Court of Appeals for the District of Columbia interpreted the *Bowman* case by following the "view which leads to the fullest presentation of facts". *Frank Fryer* v. *United States*, 207 F. 2d 134, certiorari denied Nov. 16, 1953, Docket No. 311. The denial of certiorari in the *Fryer* case confirms the view that the dominant purpose of the rules was to achieve a fair balance between the Government and the defendant so as to bring about fairness in the administration of criminal proceedings.

Even in the absence of specific legislation, this court held, in *Gordon* v. *United States*, 344 U.S. 414, 420, that "for production purposes, it need only appear that the evidence is relevant, competent, and outside of any exclusionary rule * * *".

When tested by such a construction, it appears that the court below has misconceived the purpose of the rules and has adopted, instead, an interpretation which is harsh and unduly restrictive.

IV

Outside Contacts With a Jury Raise a Presumption of Prejudice and Petitioner's Motion for a Hearing Should Have Been Granted.

On February 22, 1952, the date that the verdict was returned, petitioner's counsel gave oral notice of a motion for new trial, and defendant's time to file a written motion was extended to February 29, 1952 (R. 105). On February 29, 1952, the motion for new trial was filed (R. 106-110).

Ground 17 (R. 109-110) set forth that petitioner was substantially prejudiced and deprived of a fair trial by reason of the acts and conduct of the jury, the court, the prosecuting attorneys, and the agents of the Federal Bureau of Investigation, as described in an accompanying affidavit. Ground 17 included a motion that there be a trial of the issue and that evidence be taken from all participants in the jury incident. The accompanying affidavit (R. 111-114) recited the gist of two newspaper articles, submitted

copies of the articles which had appeared in two California newspapers on February 24, 1952 (R. 114-120), stated the probable prejudice, and renewed the request for a hearing. The newspaper articles were to the effect that the foreman of the jury had received a suggestion that money might be paid him to influence the verdict, that the trial judge had caused an investigation to be made without notifying the defense, and had concluded that the incident was harmless.

The motion for new trial was heard by the trial judge on February 29, 1952 (R. 92) and defendant's counsel stated that since the court had already ruled on every ground set forth, with the exception of Ground 17, that no argument would be presented unless the court indicated that argument would in any wise change the decision. Counsel pointed out that Ground 17 involved matters which had recently come to their attention and renewed the request "for an opportunity to obtain evidence in that connection by hearing" (R. 93). The motion was denied on all grounds (R. 94). The court made no comment and gave no reason.

Relying solely on the newspaper stories, the Court of Appeals held that petitioner had failed to show any prejudice, and that he had the burden of so showing before any hearing would be required. The court suggested that petitioner should have supplied affidavits by jurors, showing that they had received communications which would tend to prejudice them. Accordingly, the court below sanctioned the denial of petitioner's motion by the trial court (R. 3776-3777). Thus, the court departed from the well-settled principle that outside contacts with a jury raise a presumption of prejudice, *Mattox* v. *United States*, 146 U.S. 140, 150, and that the presumption can be overcome only by affirmatively showing that there was no prejudice in fact. *Stone* v. *United States*, 113 F. 2d 70, 77-78 (CA 6); *Little* v. *United States*, 73 F. 2d 861 (CA 10); *Wheaton* v. *United States*, 133 F. 2d 522 (CA 8).

It is well settled that affidavits of jurors are not competent evidence as to whether or not they were prejudiced. Such affidavits are competent only to indicate the existence of extraneous interferences with the jurors' deliberations. *Wheaton* v. *United States,* supra, p. 526. Since the newspaper stories upon which the court below relied plainly showed that the trial court as well as the prosecuting attorneys were fully aware of the facts, it is clear that the suggested affidavits would have been empty formalities and would have been competent evidence only with respect to the actual occurrence of the incident, concerning which there was no question.

We submit that orderly procedure required a hearing to determine the facts so that there would be a definite record of the details of the incident. In *Ryan* v. *United States,* 191 F. 2d 779 (CA DC), the record showed that several jurors and other witnesses were examined and cross-examined. The court approved this procedure and said, p. 781, "the trial court adopted the appropriate procedure of probing the matter by an extensive hearing".

In its present condition the record does not disclose whether the purpose of the FBI investigation was to inquire into the conduct of defense agents or to ascertain the effect on the jury. There was no opportunity for defense counsel to ascertain whether the jurors had been subjected to a grilling, whether they believed that the investigation remained inconclusive until the end of the trial, and whether any of them were apprehensive lest their verdict for acquittal might result in suspicion and criticism. In fact, none of the pertinent details are shown.

We submit that having been excluded from the investigation, the defense was entitled to have the aid of the court in adducing the facts and making a reviewable record. On this barren record, this Court can not determine the question of prejudice but we submit that the resolution of that question may not properly be left solely to the district judge, with no opportunity for an independent appraisal

on appeal. We submit further that petitioner has been convicted by a jury which was subjected to outside influences of a character calculated to affect its deliberations and that the assertions of probable prejudice to the petitioner set forth in the affidavit (R. 112) were well taken. On this point, justice requires that this case be remanded for the purpose of holding a hearing and that the district court be required to pass on the motion in the light of evidence developed at such hearing.

CONCLUSION

In view of the manifest errors, the judgment of the Court of Appeals should be reversed and the case should be remanded to the District Court with direction to enter a judgment of acquittal.

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January, 1954.

APPENDIX

Statutes, Rules and Regulations Involved

Internal Revenue Code:

Sec. 41. General Rule

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annnual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.
(26 U.S.C. 1946 ed., Sec. 41)

Sec. 51. Individual Returns

(a) *Requirement.* Every individual having for the taxable year a gross income of $600 or more shall make a return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury. Such return shall set forth in such cases, and to such extent, and in such detail, as the Commissioner with the approval of the Secretary may by regulations prescribe, the items of gross income and the deductions and credits allowed under this chapter and such other information for the purpose of carrying out the provisions of this chapter as may be prescribed by such regulations.
(26 U.S.C. 1946 ed., Sec. 51(a))

Sec. 61. Laws Made Applicable

All administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, shall be extended to and made a part of this chapter. * * *
(26 U.S.C. 1946 ed., Sec. 61)

Sec. 145. PENALTIES.

* * * * *

(b) *Failure to collect and pay over tax, or attempt to defeat or evade tax.* Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.
(26 U.S.C. 1946 ed., Sec. 145(b).)

Sec. 272. PROCEDURE IN GENERAL.

(a) (1) *Petition to Board of Tax Appeals.*[1] If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this chapter, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this chapter and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such ninety-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3653(a) the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court. * * *
(26 U.S.C. 1946 ed., Sec. 145(b))

[1] Name changed to The Tax Court of the United States. See section 1100 of this title.

Sec. 3612. RETURNS EXECUTED BY COMMISSIONER OR COLLECTOR.

(a) *Authority of Collector.*—If any person fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise.

(b) *Authority of Commissioner.*—In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise—

(1) *To Make Return.*—Make a return, or

(2) *To Amend Collector's Return.*—Amend any return made by a collector or deputy collector.

(c) *Legal Status of Returns.*—Any return or list so made and subscribed by the Commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.

(d) *Additions to Tax.*—

(1) *Failure to File Return.*—In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner or the collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax: *Provided*, That in the case of a failure to make and file a return required by law, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, if the last date so prescribed for filing the return is after August 30, 1935, then there shall be added to the tax, in lieu of such 25 per centum: 5 per centum if the failure is for not more than 30 days, with an additional 5 per centum for each additional 30 days or fraction thereof during which the failure continues, not to exceed 25 per centum in the aggregate.

(2) *Fraud.*—In case a false or fraudulent return or list is willfully made, the Commissioner shall add to the tax 50 per centum of its amount.

(3) *Cross Reference.—*

For additions to tax in the case of income tax, see sections 291 and 293, and in the case of a deficiency in gift tax, see section 1019.

(e) *Collection of Additions to Tax.*—The amount added to any tax under paragraphs (1) and (2) of subsection (d) shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

(f) *Determination and Assessment.*—The Commissioner shall determine and assess all taxes, other than stamp taxes, as to which returns or lists so made under the provisions of this section.
(26 U.S.C. 1946 ed., Sec. 3612)

Sec. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and partner.* The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.
(26 U.S.C. 1946 ed., Sec. 3797)

Revenue Act of 1951:

Sec. 340. FAMILY PARTNERSHIPS.

(a) *Definition of Partner.*—Section 3797(a)(2) is hereby amended by adding at the end thereof the following: "A person shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person."

Federal Rules of Criminal Procedure:

Rule 16. DISCOVERY AND INSPECTION.

Upon motion of a defendant at any time after the filing of the indictment or information, the court may order the attorney for the government to permit the defendant to inspect and copy or photograph designated books, papers, documents or tangible objects, obtained from or belonging to the defendant or obtained from others by seizure or by process, upon a showing that the items sought may be material to the preparation of his defense and that the request is reasonable. The order shall specify the time, place and manner of making the inspection and of taking the copies or photographs and may prescribe such terms and conditions as are just.

Rule 17. SUBPOENA.

* * * * *

(c) *For production of documentary evidence and of objects.* A subpoena may also command the person to whom it is directed to produce the books, papers, documents or other objects designated therein. The court on motion made promptly may quash or modify the subpoena if compliance would be unreasonable or oppressive. The court may direct that books, papers, documents or objects designated in the subpoena be produced before the court at a time prior to the trial or prior to the time when they are to be offered in evidence and may upon their production permit the books, papers, documents or objects or portions thereof to be inspected by the parties and their attorneys.

U. S. Treasury Department, Bureau of Internal Revenue, Regulations 111:

Sec. 29.41-1. COMPUTATION OF NET INCOME.

Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is

to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See sections 29.42-1 to 29.42-3, inclusive.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-2. Bases of Computation and Changes in Accounting Methods.

Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. But see sections 42 and 43. See also section 48. For instance, in any case in which it is necessary to use an inventory, no method of accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See sections 29.42-2 and 29.42-3.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. (But see section 29.22(c)-5.)

The true income, computed under the Internal Revenue Code, and, if the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation), shall in all cases

be entered in the return. If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his return a separate statement setting forth for the taxable year and for the preceding year the classes of items differently treated under the two systems, specifying in particulare all amounts duplicated or entirely omitted as the result of such change.

A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. For the purposes of this section, a change in the method of accounting employed in keeping books means any change in the accounting treatment of items of income or deductions, such as a change from cash receipts and disbursements method to the accrual method, or vice versa; a change involving the basis of valuation employed in the computation of inventories (see sections 29.22(c)-1 to 29.22(c)-8, inclusive); a change from the cash or accrual method to the long-term contract method, or vice versa; a change in the long-term contract method from the percentage of completion basis to the completed contract basis, or vice versa (see section 29.42-4); or a change involving the adoption of, or a change in the use of, any other specialized basis of computing net income such as the crop basis (see sections 29.22(a)-7 and 29.23(a)-11). Application for permission to change the method of accounting employed and the basis upon which the return is made shall be filed within 90 days after the beginning of the taxable year to be covered by the return. The application shall be accompanied by a statement specifying the classes of items differently treated under the two methods and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be effected. See section 22(d) and regulations thereunder with respect to changing to optional method of inventorying goods.

Section 44 contains special provisions for reporting the profit derived from the sale of property on the installment plan.

Sec. 29.42-2. INCOME NOT REDUCED TO POSSESSION.

Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

Sec. 29.3797.4. PARTNERSHIPS.

The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law, but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. • • •

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